The Wyoming RIK Pilot: Management Briefing

April 21, 1998

Briefing Overview

- Preliminary Design of Wyoming Pilot
- Markets and Marketing
- Where do we stand now?
- Recommendations and Implementation

Preliminary Design

- OBJECTIVE: A realistic test of taking Royalties in Kind for onshore oil that will provide a usable understanding of the factors that determine RIK success.
  - How, when, where, and why

- SCOPE:
  - 4000 bbls/day -- include all crude types
  - 2 - 3 year duration
  - mandatory lessee participation on selection into pilot
  - will take delivery at the royalty meter
  - Powder River and Big Horn Basins

Preliminary Design

- Wide range of leases/properties selected:
  - large, medium and small productivity
  - both pipeline and trucked production included
  - diverse geographic areas within basins
  - standard and low royalty rates
  - single + multiple fund distribution from individual properties
- Selection data
  - 178 properties (10%), including 563 leases (20% of total)
  - 63 operators (out of 266 total operators)
  - 72% of ~~leases~~ properties trucked; 28% by pipeline

Preliminary Design

- PROJECT PHASES (tentative)
  - DESIGN PHASE:
    - data collection and analysis
    - bidding and procurement activities
    - finalize reporting and verification systems
    - lessee/operator notification
  - PHASE 1:
    - Lease sales by competitive bidding
    - October 1998 - September 1999
  - PHASE 2:
    - Sales by Marketing Agent
    - October 1999 - September 2000 ?
  - PROJECT EVALUATION

Markets and Marketing

- Wyoming Market overview:
  - 3 basic types of Crude:
    - sweet, sour, asphaltic sour
  - Increased Canadian imports into region
  - a regional market - little oil moves outside Rockies
  - Sweet crude priced relative to local postings and Cushing spot
  - sour crudes priced on local postings almost exclusively
  - Marketer margins: 10 cents/bbl or less -- no excess profits to "share" with government

Markets and Marketing

- PHASE 1 Marketing
  - Lease sales by competitive bidding
  - bid contracts for 6 months for all crude types (2 cycles)
  - property by property bidding and entire packages
    - is package bid greater than sum of individual property bids?
  - Bid basis-
    - Sweet: Platts' P+, NYMEX, Cushing WTI Spot prices
    - Sour: Average of (non-producer) postings
  - Bid Analysis-
    - projected royalty in value receipts for each property
    - retain right to reject bids lower than projected receipts

Markets and Marketing

- PHASE 2 Marketing
  - Marketers to act as MMS "agents" to sell crude
  - one marketer for each crude type (sweet, sour, asphaltic)
  - one year contract - extend at MMS option to 2 years
  - marketer costs and revenues:
    - guaranteed minimum plus percent of proceeds; *or*
    - gross proceeds less costs and negotiated fee
  - How do we structure contract to avoid costly contract oversight and auditing, and marketer administrative cost?

Markets and Marketing

- PHASE 1 vs. PHASE 2 Marketing
  - Phase 1 advantages:
    - Consistent with industry practice - most production sold by producer
    - no transport cost, or tracing of production
    - no marketer fee or procurement costs
    - no rule required
    - could determine "true" market value at lease
  - Phase 1 disadvantages:
    - loss of "potential" downstream values
    - may not be better than in-value proceeds
    - success depends on competition at lease, which in many cases is limited, and therefore on our ability to increase competition

Markets and Marketing

- PHASE 1 vs. PHASE 2 Marketing
  - Phase 2 advantages:
    - will realize any "potential"downstream values
    - better aggregation potential
    - supported by industry and Wyoming
  - Phase 2 disadvantages:
    - administrative complexity and cost for marketer and MMS
    - need to trace sales, account for transportation + other services
    - rule required to implement
    - marketer fees/costs could exceed any value benefits
- Value in assessing which works best

Where do we stand?

- Wyoming has stated publicly that we should "hire" a "Qualified Marketing Agent"
  - but will withhold judgement until fully briefed on plan
- Could skip Phase 1 and start with Phase 2
  - pilot would be delayed minimum of 6 months for rulemaking
    - potential for industry to question our veracity and intent
    - potential for industry to support selection
    - potential for industry to point to rulemaking as need for legislation
- Other Options?
  - Hybrid marketing: sell at lease with downstream participation?
  - Other ideas?

Recommendations

- Value to proceeding with both Phase 1 and Phase 2
  - Implement Phase 1 and Phase 2 as outlined subject to Wyoming approval
  - Wyoming rejects, recommend proceeding directly to Phase 2, beginning April 1, 1999 (provided rule is complete)
- Other possibilities considered:
  - Concurrent lease sales and marketer sales
    - to have economic RIK quantities, would have to double pilot size
    - insufficient volume remaining for adequate "real-time" in-value benchmark
    - still requires 6 month + delay

Implementation Issues

- Administration of ongoing pilots
  - team will be working on development of GOM pilot, etc.
  - need for RMP team to ensure smooth operation, reporting and collection of revenues
- RIK Rulemaking
  - to cover marketing methods, transportation + delivery issues, marketable condition, imbalances, etc.
  - Is time frame too ambitious? - go final April 1999
- Teapot Dome potential - DOE, BLM, State issues?